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Hard Choices

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were currently involved in the specialty soybean market, if they were interested in becoming involved, and where they thought the industry would be by the year 2000.

We received an enthusiastic response, in part because all the respondents expected continued strong gains in the share of soybeans sent into specialty markets. (The average participant predicted that 20 percent of all soybean sales would be identity preserved by the year 2000.)

We then sent out a much more detailed survey asking those companies already in the specialty business to document their involvement in each of the specialty markets we had identified. This information has been published in a 128-page specialty soybean directory. Call Dermot Hayes, CARD, at 515/294-6185, or Greg Ehm, ISPB, at 515/223-1423, to inquire about receiving a free copy.

Where Do We Go from Here?

While creating the specialty soybean directory we discovered that the specialty soybean business is already important and is growing rapidly. As the marketing system undergoes the transformation from a commodity-based system to a system that competes on characteristics, the Iowa soybean sector will be able to offer new customers exactly those characteristics they want. Our sense is that Iowa is at the forefront of the transition, and that Iowans will receive much of the reward.

Many of the new customers for Iowa's specialty soybeans and corn will locate near the source of production. These companies will employ geneticists, molecular biologists, and engineers to create products that we cannot begin to describe today. With some luck and continued managerial attention, the state could become home to an industry that will create as many uses for corn and soybeans as the computer industry has for the silicone chip.

Emerging Issues

Hard Choices

(William H. Meyers, 515/294-1184)
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As we go to press, both the Senate and House are acting on proposals to put the federal budget on a path to be balanced by 2002. The budget cuts proposed by both bodies are substantial but those proposed by the House are larger, since the Senate has rejected the tax cuts adopted by the House. Although the budget debates in the House and Senate and between the House and Senate are far from over, the expectation is that the Agriculture Committees will be asked to reduce farm program spending by $1.5 billion to $2 billion per year over the next seven years.

Spending caps are also being considered. Although it is not clear whether credit would be granted for years in which actual expenditures are below projections, Congressional focus is now on constraining actual expenditures in any given year as well as on changes in total expenditures over the budget period.

As the budget amounts and rules are being resolved, debate will focus on alternative ways of changing programs to reduce farm program spending and possibly to reduce the year-to-year variability of spending. These will be hard choices, as cuts of this magnitude are difficult to achieve without reducing farm income. Moreover, the different ways to achieve the proposed reductions involve a broad range of distributional impacts by commodity, region, and type of farm.

Budget Cut Options

As of this writing, FAPRI has not yet analyzed specific options to achieve a particular budget target. However, studies that have been done can be used to gain some insight into likely impacts. The cost and net farm income impacts of several options are summarized and compared below:

1. 25 percent Flex. Increasing flex acres reduces payment acres and reduces participant returns and participation rates, while giving farmers more flexibility in using base acres for other crops. An analysis of increasing flex acres from the current 15 percent to 25 percent estimates a budget savings of $1.28 billion per year and a net farm income loss of $1.1 billion per year (*FAPRI Report 3-95*). This implies that net farm income declines $85 for each $100 of budget savings. It also indicates that an increase to 25 percent flex is not sufficient to meet current budget targets, so this approach would require higher flex rates and/or other program cuts.

2. Elimination of 0-50/85 Program. The 0-50/85 Program pays farmers 85 percent of deficiency payments on base area where less than 85 percent of permitted plantings are actually planted. For rice, 50 percent of base acres must be planted to qualify.

Elimination of this program is estimated to save $280 million per year and reduce net farm income by $150 million per year (*FAPRI Report 4-95*). This makes a very small contribution to budget savings, but net farm income declines only $54 for each $100 of budget savings.

3. Major program reform. FAPRI recently evaluated three major alternatives to current programs, all of which, at a minimum, eliminated current target prices, ARPs, and 0-50/85 (see "Three Corners" article in this issue). In other respects these options are quite different from each other, but two of them have estimated budget savings that are greater than those currently being proposed by Congress. These two are the No Program scenario and the Revenue Assurance scenario. In these two scenarios, we can roughly approximate the impacts of smaller budget cuts by giving the "excess budget savings" back to farmers in the form of decoupled cash payments. (Of course, Congress could also use some of the "excess budget savings" to restore some of the planned cuts in market development, conservation, or research.)

Budget Cut Impacts

The following assumptions are made to find these approximate impacts. We use a target budget reduction of $1.6 billion per year and subtract this from the estimated budget savings in each of the two scenarios. This difference constitutes the "excess budget savings" that is assumed to be distributed to farmers in the same way that transition payments are made in the Revenue Assurance scenario. That is, they are paid in proportion to the average target and marketing loan deficiency payments over the last five years. These payments are assumed to have no impact on production decisions, so they change net farm income but do not alter the market results of the previous analysis. The payments are set in advance, so they involve no budget exposure beyond these certain payments. A five-year period is used for these approximations, though a seven-year analysis would not differ greatly. The results are presented in the table below.

The No Program scenario is estimated to save $7.54 billion per year, so $5.94 billion is available for annual decoupled payments. As a result, the adjusted net farm income drops by less than $1 billion per year compared with current program levels. This implies that net farm income would drop about $60 for each $100 of budget savings.

Estimated Impact of $8 Billion Cuts on No-Program and Revenue Assurance

	Five-Year Total (billion $)	Annual Average (billion $)
Assumed Cut in Agriculture	8.0	1.60
No-Program Estimates		
FAPRI estimate of No Program Savings	37.7	7.54
Surplus for decoupled payments	29.7	5.94
FAPRI estimate of No-Program NFI	182.9	36.58
Added decoupled payments	29.7	5.94
Adjusted No Program NFI	212.6	42.52
Change from Baseline	-4.8	-0.96
Revenue Assurance Estimates		
FAPRI estimate of Revenue Assurance savings	15.0	3.00
Surplus for decoupled payments	7.0	1.40
FAPRI estimate of Revenue Assurance NFI	203.1	40.61
Added decoupled payments	7.0	1.40
Adjusted Revenue Assurance NFI	210.1	42.01
Increase in government-financed indemnities	2.3	0.47
Estimated value of increased insurance*	4.7	0.93
Adjusted NFI plus increased insurance value	214.7	42.94
Change from Baseline	-2.7	-0.54
Baseline Estimate		
FAPRI estimate of current program NFI	217.4	43.48

*Total amounts derived from "Risky Business" averages, pg. 8.

The Revenue Assurance scenario is estimated to save $3 billion per year, after accounting for the increased government contribution of $0.47 billion per year to replace the current crop insurance with revenue assurance. This leaves $1.4 billion available for annual decoupled payments, in addition to transition payments already included in the program design. The adjusted net farm income drops by $1.47 billion. However, this scenario differs from the others in that an average annual increase of nearly $.5 billion in government financed insurance indemnities also can be expected. This difference in cash flow by itself would reduce the farm income decline to about $1 billion or $60 for each $100 of budget savings. The "Risky Business" article in this issue indicates that the value of government financed insurance in terms of reducing cash flow risk has been estimated at two times the indemnities payments. Using this factor, net farm income plus the value of insurance drops by $.54 billion per year compared with current program levels. This measure of farm sector well-being, therefore, falls by about $34 for each $100 of budget savings.

The main reason that the adjusted No Program and adjusted Revenue Assurance scenarios indicate a smaller income loss per dollar of budget savings compared with increasing flex acres is that these scenarios remove more of the current program constraints, and farming efficiency increases. We have assumed that the decoupled payments are distributed exactly like recent deficiency payments, so as to retain the benefit distribution of current programs. However, Congress could decide to target these payments in another way. As long as they would remain decoupled from production decisions, the principal impact would be on the distribution of income rather than on the level of income in agriculture.

The few options presented here are limited because we have not yet done analyses for specific levels of budget savings. However, these scenarios provide some indication of how the impacts can differ under different methods of achieving budget savings.

Weather Uncertainty and Financial Risk

(Darnell B. Smith, 515/294-1184)

It could well be that for many agricultural producers in the United States, the financial risk due to unusual weather conditions is greater today than at any time in the recent past. The two primary reasons are: (1) Increasing budgetary pressure in Washington, implying that less support for agriculture will be forthcoming in future years, and (2) Last year's federal crop insurance reform, replacing agricultural disaster assistance with low-cost catastrophic (CAT) coverage, offers only minimal risk reduction, at best.

Other articles in this issue have highlighted the expectation of reduced payments to producers as, even without budget cuts, baseline projections already incorporate future payment declines. It, therefore, taxes the imagination to envision that over the medium term, future support to agriculture will, on average, be anything but less than current levels.

Effects of CAT

Although CAT replaced disaster assistance, the coverage level is, at most, 30 percent of expected revenue (50 percent of yield times 60 percent of price) and even then, half the crop must be lost before any indemnities are paid at all. This means that for midrange losses, the losses most likely to occur, producers who did not choose to buy increased coverage will receive no indemnities whatsoever from CAT. For example, suppose an Iowa corn producer expects 150 bushels per acre at a price of $2.40 per bushel. This producer could lose up to 75 bushels per acre and not be eligible for any indemnities at all. With the 50 percent yield deductible, the yield must drop below 75 bushels before coverage kicks in. For each bushel lost past the 50 percent deductible, however, the producer receives payment at 60 percent of expected price ($2.40 x .6 = $1.44 per bushel). So, in this example, if the producer harvests 70 bushels per acre, the covered losses are $7.20 per acre (5 bushels at a rate of $1.44). For every 100 acres, this producer receives $720 in insurance and $16,800 in market receipts for a total of $17,520. The $720 payment covers only 3.75 percent of the $19,200 in lost market revenue.

A comparison with the proposed Revenue Assurance program may prove useful in illustrating differences in risk exposure. If we assume that realized market price is equal to the expected price, $2.40, then the per acre assured revenue for the above example equals .70 times 150 times $2.40, or $252 per acre. In our example, actual market revenue is $168 per acre, with the covered indemnities equaling $84 per acre with total receipts of $25,200 for each 100 acres planted. Thus, this coverage provides producers with an assured cash flow large enough to cover variable cost and some proportion of other costs and expenditures. And in situations of midrange losses, the kind most likely to occur, Revenue Assurance offers a much greater degree of cash flow risk reduction than the CAT.